

CYGAM ENERGY INC.

Consolidated Financial Statements

For the Years ended December 31, 2006 and 2005

MANAGEMENT'S REPORT

To the Shareholders of Cygam Energy Inc.

The accompanying financial statements of Cygam Energy Inc. are the responsibility of management. Management is responsible for and has prepared and presented the financial statements in accordance with Canadian generally accepted accounting principles (GAAP) and has made significant accounting judgments and estimates as required. Management has ensured that financial information contained elsewhere in this report is consistent with the financial statements.

Management is also responsible for maintaining a system of internal controls designed to provide reasonable assurance that assets are safeguarded and that the accounting system provides timely, accurate and reliable financial information.

The Audit Committee is appointed by the Board and has full and free access to the external auditors. The Committee meets periodically with management, as well as the external auditors, to discuss internal controls over the financial reporting process, auditing matters and financial reporting issues; to satisfy itself that each party is properly discharging its responsibilities; and, to review the annual report, the financial statements and the external auditors' report. The Committee reports its findings to the Board for consideration when approving the financial statements for issuance to the shareholders. The Committee also considers, for review by the Board and approval by the shareholders, the engagement or re-appointment of the external auditors.

PricewaterhouseCoopers LLP, an independent firm of Chartered Accountants, is appointed by the Board during the year on behalf of the shareholders to express an opinion as to whether the financial statements present fairly the Company's financial position, results of operations and cash flows in accordance with GAAP for the year ended December 31, 2006. The Board of Directors has approved the financial statements of the Company on the recommendation of the Audit Committee.

(signed) *"Dario E. Sodero"*

Dario E. Sodero
President and Chief Executive Officer

April 25, 2007

(signed) *"S. S. (Ali) Rawji"*

S. S. (Ali) Rawji
Chief Financial Officer

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AUDITORS' REPORT

To the Shareholders of Cygam Energy Inc.

We have audited the consolidated balance sheet of Cygam Energy Inc. at December 31, 2006 and the consolidated statements of operations and retained earnings and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The financial statements as at December 31, 2005 and for the year then ended, were audited by other auditors who expressed an opinion without reservation on those statements in their report dated March 30, 2006.

PricewaterhouseCoopers LLP

Chartered Accountants
Calgary, Canada
April 25, 2007

CYGAM ENERGY INC.

CONSOLIDATED BALANCE SHEETS

As at	December 31 2006	December 31 2005 (notes 1 & 3)
	(\$)	(\$)
Assets		
Current assets		
Cash	5,321,555	8,425,818
Marketable securities (note 4)	3,532,814	5,067,692
Accounts receivable	344,551	480,513
Prepays and deposits	43,142	14,366
	9,242,062	13,988,389
Property, plant and equipment (note 5)	8,680,270	6,012,475
	17,922,332	20,000,864
Liabilities and Shareholders' Equity		
Current liabilities		
Accounts payable and accrued liabilities	735,357	1,159,942
Current portion of long-term debt (note 7)	27,000	27,000
	762,357	1,186,942
Long-term debt (note 7)	32,083	59,083
Asset retirement obligation (note 6)	95,208	80,475
Future income tax liability (note 11)	173,833	164,950
	1,063,481	1,491,450
Shareholders' equity		
Share capital (note 8)	14,303,681	14,291,305
Contributed surplus (note 9)	1,436,586	977,829
Cumulative translation adjustments	(124,225)	(391,538)
Retained earnings	1,242,809	3,631,818
	16,858,851	18,509,414
Commitments (note 14)	17,922,332	20,000,864

See accompanying notes to the consolidated financial statements

On behalf of the Board of Directors,

(signed) "Dario E. Sodero"

Director

(signed) "S. S. (Ali) Rawji"

Director

CYGAM ENERGY INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

Years Ended	December 31 2006	December 31 2005 (notes 1 & 3)
	(\$)	(\$)
Revenue		
Petroleum and natural gas sales	596,312	286,300
Royalties expense, net of Alberta Royalty Tax Credit	(118,032)	(76,275)
Other revenue	698,131	232,500
	1,176,411	442,525
Expenses		
Production	218,342	52,942
General and administrative	1,178,726	527,815
Interest	4,922	2,541
Stock-based compensation	459,932	553,809
Depletion, amortization and accretion	216,168	42,178
Loss (gain) on foreign exchange	3,923	(325,363)
	2,082,013	853,922
Other income and expenses		
Gain on sale of marketable securities	-	(4,827,555)
Unrealized loss on marketable securities	1,534,878	932,308
Earnings (loss) before income taxes	(2,440,480)	3,483,850
Income tax recovery (note 11)	51,471	10,978
Net earnings (loss) for the year	(2,389,009)	3,494,828
Retained earnings, beginning of year	3,631,818	136,990
Retained earnings, end of year	1,242,809	3,631,818
Earnings (loss) per share		
Basic (Note 10)	(0.033)	0.072
Diluted (Note 10)	(0.033)	0.065

See accompanying notes to the consolidated financial statements.

CYGAM ENERGY INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended	December 31 2006	December 31 2005 (notes 1 & 3)
	(\$)	(\$)
Cash provided by (used in):		
Operations		
Net earnings (loss) for the year	(2,389,009)	3,494,828
Add items not affecting cash:		
Income tax recovery	(51,471)	(10,978)
Stock based compensation expense	459,932	553,809
Depletion, amortization and accretion	216,168	42,178
Gain on sale of marketable securities	-	(4,827,555)
Loss (gain) on foreign exchange	3,923	(325,363)
Unrealized loss on marketable securities	1,534,878	932,308
Abandonment expenditures	(4,513)	(19,353)
	(230,092)	(160,126)
Change in non-cash operating working capital		
Accounts receivable	156,347	119,384
Prepays and deposits	(27,050)	(14,366)
Accounts payable	240,012	(16,882)
Income taxes payable	60,354	-
	199,571	(71,990)
Investing		
Expenditures on property, plant and equipment	(2,643,046)	(1,563,596)
Proceeds on sale of marketable securities	-	4,943,110
Cash acquired on business combinations	-	132,305
Change in non-cash working capital	(672,074)	-
	(3,315,120)	3,511,819
Financing		
Increase (decrease) in shareholder loan	-	(57,532)
Issue of capital stock for cash (note 8(b))	11,200	5,600,000
Repayment of bank loan	(27,000)	(6,750)
Share issue costs (note 8(b))	-	(552,844)
	(15,800)	4,982,874
Foreign exchange gain (loss) on cash and cash equivalents	27,086	-
Increase (decrease) in cash	(3,104,263)	8,422,703
Cash, beginning of year	8,425,818	3,115
Cash, end of year	5,321,555	8,425,818

The Company paid interest of \$4,922 (2005 - \$2,541) and received income taxes of \$60,354 (2005 - \$nil).

See accompanying notes to the consolidated financial statements.

CYGAM ENERGY INC.
Notes to the Consolidated Financial Statements
Years ended December 31, 2006 and 2005

1. NATURE OF OPERATIONS

Cygam Energy Inc. (“Cygam” or the Company) is a public company engaged in the exploration, development and production of crude oil and natural gas in Alberta, Tunisia, and Italy. Cygam was formed through the reverse takeover of Sheer Energy Inc. by Rigo Oil Company Limited (“ROCL”) on October 11, 2005, and the acquisition of all the outstanding shares of Vega Oil S.p.A. (“Vega”). At the same time, Cygam also acquired 199,594 units of Peyto Energy Trust from the major shareholder of ROCL. ROCL and Vega were private companies (related by common control) engaged in the business of oil and gas exploration in Tunisia and Italy respectively. Cygam’s common shares trade on the TSX Venture Exchange under the symbol CYG.

The accompanying financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The acquisition of ROCL has been accounted for as a reverse takeover of Sheer Energy Inc. by ROCL effective October 11, 2005, and as a result the financial statements of the Company for the year ended December 31, 2005 treat ROCL as the acquiring company and therefore all pre-acquisition date results reflect the operations of ROCL only.

2. SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada within the framework of the accounting policies summarized below:

a) Use of Accounting Estimates

The preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Such estimates primarily relate to unsettled transactions and events at the balance sheet date. Actual results could differ from those estimated. Specifically, the amounts recorded for depletion, depreciation, accretion and asset retirement obligations and amounts used for ceiling test and impairment calculations are based on estimates of proven reserves, future oil and natural gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the consolidated financial statements of changes in such estimates in future periods could be significant.

The amount of stock-based compensation expense accrued is based on management’s estimate of assumptions underlying the calculation of the fair value of stock options granted.

b) Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Rigo Oil Company Limited, Rigo Oil Company Tunisia Ltd., and Vega Oil S.p.A.

CY GAM ENERGY INC.
Notes to the Consolidated Financial Statements
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2. SIGNIFICANT ACCOUNTING POLICIES (continued)

c) Foreign Currency Translation

The Company's Italian and Tunisian operations are considered self-sustaining and are translated into Canadian dollars using the current rate method. Under this method, assets and liabilities are translated at period-end exchange rates and items included in the statements of operations and retained earnings and cash flows are translated at the average rates in effect during the period. The gain or loss on translation is charged to cumulative translation adjustment in shareholders' equity.

Any amounts payable and receivable in foreign currencies are revalued at the balance sheet date and any gains or losses arising on the revaluation are reflected in earnings for the period.

d) Revenue Recognition

Revenues associated with sales of petroleum and natural gas and all other items are recorded when title passes to the buyer.

e) Property, Plant & Equipment

Capitalized Costs

The Company follows the full cost method of accounting for exploration and development expenditures whereby all costs relating to the acquisition of, exploration for and development of petroleum and natural gas reserves, whether productive or unproductive are capitalized. Such costs include land and lease acquisition costs, geological and geophysical costs, lease rentals on undeveloped properties, drilling both productive and non-productive wells, production equipment and general and administrative expenses directly related to acquisition, exploration and development activities. Capitalized costs are accumulated on a country-by-country basis.

Proceeds received from disposals of petroleum and natural gas properties and production equipment are credited against capitalized costs unless the disposal would alter the rate of depletion and depreciation by more than 20%, in which case a gain or loss on disposal is recorded.

CYGAM ENERGY INC.

Notes to the Consolidated Financial Statements

Years ended December 31, 2006 and 2005

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Depletion, amortization and accretion

All costs of acquisition, exploration and development of oil and gas revenues, associated tangible plant and equipment costs (net of salvage value) and estimated costs of future development of proven reserves are depleted and depreciated by the unit-of-production method based on estimated gross proved reserves as determined by independent engineers on a country-by-country basis. Oil and gas reserves are converted to equivalent units using their estimated relative energy content of six thousand cubic feet of gas to one barrel of oil. The cost of unproved properties is excluded from the depletion calculation and is assessed periodically to ascertain whether impairment has occurred. When proved reserves are assigned or the property is considered impaired, the cost of the property or the amount of the impairment is added to all other capitalized costs subject to depreciation and depletion.

Depreciation of furniture, fixtures and office equipment is provided using the diminishing balance method at rates between 20% and 50%.

Ceiling test

The Company applies a ceiling test to capitalized costs to ensure that the net carrying value of petroleum and natural gas properties does not exceed the estimated value of future net cash flows (based on estimates of future prices and costs projected by the company from independent engineers' reports) from the production of proven reserves, less estimated future major development and site restoration costs. Any impairment in value is charged to operations.

Upon recognition of impairment, the Company would then measure the amount of impairment by comparing the carrying amounts of the PP&E to the fair value of PP&E which is the estimated net present value of future cash flows from proved plus probable reserves. A risk-free interest rate is used to arrive at the net present value of future cash flows. Any excess carrying value above the net present value of the future cash flows would be recorded as a permanent impairment.

f) Interest in Joint Ventures

A portion of the Company's petroleum and natural gas exploration and development activities are conducted jointly with others, and accordingly, the financial statements reflect only the Company's proportionate interest in such activities.

g) Marketable Securities

Marketable securities represents an investment in trust units of a public company which on acquisition was designated as held for trading and is stated at fair value, without any deduction for transaction costs that may be incurred on sale or disposal. Any unrealized loss is recognized in net income in the period in which it arises. Distributions received are accounted for as revenue.

CY GAM ENERGY INC.
Notes to the Consolidated Financial Statements
Years ended December 31, 2006 and 2005

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

h) Cash and Cash Equivalents

The Company considers deposits in banks, certificates of deposit and short-term investments with original maturities of three months or less as cash and cash equivalents.

i) Per Share Amounts

Basic per share amounts are calculated using the weighted average number of common shares outstanding during the year. Diluted per share amounts are calculated based on the treasury-stock method, which assumes that any proceeds obtained on exercise of options and warrants would be used to purchase common shares at the average market price during the period. No adjustment to diluted earnings per share is made if the result of this calculation is anti-dilutive.

j) Asset Retirement Obligations

The Company recognizes the estimated liability associated with an asset retirement obligation (ARO) in the financial statements at the time when fieldwork related to the acquisition of seismic or drilling activity has occurred on the asset and a liability is incurred. The estimated fair value of the ARO liability is recorded as a long term liability, with a corresponding increase in the carrying amount of the related asset. The capitalized amount is depleted based on a unit-of-production method and the amount of accretion is charged to earnings in the period. The ARO can also increase or decrease due to changes in the estimates of timing of cash flows or changes in the original estimated undiscounted cost. Actual costs incurred upon settlement of the ARO are charged against the ARO recorded.

k) Income Taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, the Company records future income taxes for the effect of any differences between the accounting and the income tax basis of an asset or liability using income tax rates substantively enacted on the balance sheet date. The effect of a change in income tax rates on the future income tax assets and liabilities is recognized in income in the period of the change. Future income tax assets are limited to the amount that is more likely than not to be realized.

CYGAM ENERGY INC.
Notes to the Consolidated Financial Statements
Years ended December 31, 2006 and 2005

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

I) Stock-Based Compensation

Compensation costs attributed to all stock options granted to employees, officers and directors are measured at fair value at the date of grant using the Black Scholes option pricing model and expensed over the vesting period with a corresponding increase to contributed surplus. Upon exercise of the option, consideration received together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

III) Comparative Amounts

Certain comparative amounts have been reclassified to conform with the presentation format adopted in the current year.

CYGAM ENERGY INC.
Notes to the Consolidated Financial Statements
Years ended December 31, 2006 and 2005

3. ACQUISITION AND REVERSE TAKEOVER

On October 11, 2005, Sheer Energy Inc. changed its name to Cygam Energy Inc. Effective October 11, 2005, Cygam acquired all of the issued and outstanding shares of Rigo Oil Company Limited (“ROCL”), an oil and gas exploration company with operations in Tunisia, and Vega Oil S.p.A. (“Vega”), an oil and gas exploration company with operations in Italy, and cancelled the outstanding shareholder loans in ROCL and Vega in exchange for common shares of Cygam. As consideration, Cygam issued 42,000,000 common shares and 11,066,666 Series “A” Warrants. Cygam also purchased \$6,000,000 in units of Peyto Energy Trust from the shareholders of ROCL in exchange for 13,333,333 common shares of Cygam. As a result of this transaction, the former shareholders of ROCL obtained ownership control of Cygam and accordingly, the acquisition has been accounted for as a reverse takeover of Cygam by ROCL.

The acquisition of Cygam by ROCL has been accounted for using the purchase method. The acquisition of Vega by ROCL is a related party transaction between companies under common control and has been accounted for at the carrying amount as recorded in the accounts of Vega. Results of operations of Cygam and Vega are included from the date of acquisition. The purchase equation is as follows:

Fair value or carrying amount of net assets acquired

	Cygam (Sheer)	Vega
Cash	\$ 22,227	\$ 110,078
Accounts receivable and prepaids	270,557	35,622
Property, plant and equipment	1,555,189	27,768
Accounts payable and accrued liabilities	(124,866)	(10,522)
Bank loan	(92,833)	-
Shareholder loan payable	-	(112,992)
Asset retirement obligations	(74,811)	-
Future income tax	(361,793)	-
Total net assets	\$ 1,193,670	\$ 49,954

Consideration consists of:

Common shares	\$ 1,193,670	\$ 49,954
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Application of the reverse takeover accounting results in the following:

- (a) The financial statements of the consolidated entity are issued under the name of Cygam Energy Inc., but are considered the continuation of the financial statements of ROCL. The issued share capital of the entity at October 11, 2005 is that of ROCL plus the value of the net assets of Cygam while the legal capital structure remains that of Cygam.

CYGAM ENERGY INC.
Notes to the Consolidated Financial Statements
Years ended December 31, 2006 and 2005

3. ACQUISITION AND REVERSE TAKEOVER (continued)

- (b) As ROCL is the deemed acquirer for accounting purposes, its assets, liabilities and operations since incorporation are included in these financial statements at their historical carrying value. The operations of Cygam are included from October 11, 2005.
- (c) Control of the assets and operations of Cygam is considered to be acquired by ROCL. For the purposes of this transaction, the consideration is deemed to be the fair value of the net assets of Cygam, which was \$1,193,670 at October 11, 2005, determined by the fair value of the consideration given by ROCL. The cost of the purchase exceeded the net book value of Cygam at October 11, 2005 by \$499,003, and the excess amount was allocated to Cygam's oil and gas properties, based on their fair values, with the associated tax effect recorded to future income tax liability.
- (d) Direct expenses amounting to \$328,257, including legal, accounting, consulting and stock exchange fees, incurred in connection with the reverse takeover have been treated as a capital transaction.

4. MARKETABLE SECURITIES

The following table sets out the changes in the marketable securities:

	2006	2005
Balance, beginning of year	\$ 5,067,692	\$ 115,555
Sold during the year	-	(115,555)
Acquired during the year	-	6,000,000
Unrealized gain (loss) during the year	(1,534,878)	(932,308)
Balance, end of year	\$ 3,532,814	\$ 5,067,692

CYGAM ENERGY INC.
Notes to the Consolidated Financial Statements
Years ended December 31, 2006 and 2005

5. PROPERTY, PLANT AND EQUIPMENT

As at December 31, 2006	Cost	Accumulated depletion & amortization	Net book value
Petroleum and natural gas properties	\$ 9,513,887	\$ 1,107,899	\$ 8,405,988
Asset retirement costs	123,215	49,880	73,335
Building	196,538	39,344	157,194
Furniture, fittings and office equipment	79,519	35,766	43,753
Total	\$ 9,913,159	\$ 1,232,889	\$ 8,680,270

As at December 31, 2005	Cost	Accumulated depletion & amortization	Net book value
Petroleum and natural gas properties	\$ 6,661,003	\$ 913,647	\$ 5,747,356
Asset retirement costs	105,527	44,498	61,029
Building	196,538	32,896	163,642
Furniture, fittings and office equipment	65,320	24,872	40,448
Total	\$ 7,028,388	\$ 1,015,913	\$ 6,012,475

The Company capitalized \$207,382 (2005 - \$ 98,935) of general and administrative expenses directly related to exploration activity in Italy and Tunisia. The Company did not capitalize any general and administrative expenditures in Canada.

Permit, seismic and drilling costs associated with unproved properties that were excluded from depletion and amortization were \$6,598,564 (2005 - \$4,352,789). Future development costs of \$476,000 are included in the calculation of the depletion and amortization expense.

Ceiling Test

The Company calculated a ceiling test at December 31, 2006 to assess the recoverable value of the petroleum and natural gas properties and production equipment. The future prices used by the company in estimating cash flows were based on forecasts by the independent reserves evaluators, adjusted for the Company's quality and transportation differentials. At December 31, 2006, there was no impairment to the carrying costs of petroleum and natural gas properties.

CY GAM ENERGY INC.
Notes to the Consolidated Financial Statements
Years ended December 31, 2006 and 2005

5. PROPERTY, PLANT AND EQUIPMENT (continued)

The following table summarizes the benchmark price and exchange assumptions used in the calculation for the Canadian properties:

	WTI Oil (\$US/bbl)	Edmonton Light Crude Oil (\$Cdn/bbl)	Bow River Medium (\$Cdn/bbl)	Cromer Medium Crude Oil (\$Cdn/bbl)	AECO-C Gas (\$Cdn/Mmbtu)	Foreign Exchange (\$US/Cdn)
2007	63.00	70.55	50.55	60.55	7.35	0.88
2008	61.50	68.80	49.80	59.80	7.65	0.88
2009	60.00	67.10	49.10	58.60	7.80	0.88
2010	58.00	64.85	47.85	56.35	7.90	0.88
2011	58.00	64.85	47.85	56.35	7.95	0.88
2012-	2.0%	2.0%	2.0%	2.0%	2.0%	0.88
2016	escalated	escalated	escalated	Escalated	escalated	

6. ASSET RETIREMENT OBLIGATION

At December 31, 2006, the estimated total undiscounted amount of cash flows required to settle the ARO was approximately \$134,156 (2005 - \$113,395), which will be incurred between 2007 and 2013. The company's asset retirement obligation results from its responsibility to abandon and reclaim its net share of all working interest properties. The amount has been discounted using a credit adjusted risk free interest rate of 8% and an inflation rate of 2.0%. A reconciliation of the ARO is provided below:

	2006	2005
Balance, beginning of period	\$ 80,475	\$ 74,811
Expenditures during the period	(4,513)	(935)
Revisions in estimates of timing of cash flows	12,808	5,130
Accretion expense	6,438	1,469
Balance, end of year	\$ 95,208	\$ 80,475

Revisions are the result of extended reserve life as evaluated by the independent reserves evaluators.

CYGAM ENERGY INC.
Notes to the Consolidated Financial Statements
Years ended December 31, 2006 and 2005

7. LONG-TERM DEBT

	2006	2005
Office condominium mortgage, due on demand, with payments of \$2,250 monthly plus interest calculated at the bank's prime rate plus 1% per annum	\$ 59,083	\$ 86,083
<hr/>		
Estimated principal repayments are as follows:		
2007 – current portion of long-term debt	\$ 27,000	
2008	27,000	
2009	5,083	

Under a credit facility dated March 19, 2004, the Company has the following credit facilities available:

- (a) Office condominium mortgage, as above.
- (b) Operating loan up to \$150,000 available by way of account overdraft. The loan is due on demand by the bank with interest paid at the bank's prime rate plus 1% per annum.

The loans are secured by a debenture and general security agreement with a fixed and floating charge over all assets and an assignment of all risk insurance proceeds, and an environmental indemnity.

8. SHARE CAPITAL

a) Authorized

Unlimited number of common shares without par value.
Unlimited number of first preferred shares, of which none have been issued.
Unlimited number of second preferred shares, of which none have been issued.

CYGAM ENERGY INC.
Notes to the Consolidated Financial Statements
Years ended December 31, 2006 and 2005

8. SHARE CAPITAL (continued)

b) Issued and Outstanding

In accordance with accounting for reverse takeover, the authorized and issued share capital is that of Cygam while the stated value is that of Rigo Oil Company Limited.

	Shares (#)	Amount (\$)
Common Shares		
Balance at December 31, 2004	20	24
Issued pursuant to conversion of shareholder loans to equity on October 11, 2005	5	2,238,655
Balance as at October 11, 2005	25	2,238,679
Outstanding common shares of Cygam, at October 11, 2005	6,557,863	1,193,670
Common shares issued pursuant to:		
Cygam shares exchanged for ROCL shares	41,666,667	2,238,679
Acquisition of Vega	333,333	49,954
Acquisition of Peyto Energy Trust units	13,333,333	6,000,000
Non-brokered private placement	4,444,444	2,000,000
Brokered private placement	6,000,000	3,600,000
Transfer to Contributed Surplus account re. fair value of broker warrants, Series "A" warrants issued pursuant to the non-brokered private placement and Series "B" warrants	-	(424,020)
Share issue costs and direct expenses of the reverse takeover (net of tax effect of \$185,866)	-	(366,978)
Balance, December 31, 2005	72,335,640	14,291,305
Issued upon exercise of Series B Warrants	14,000	12,376
Balance, December 31, 2006	72,349,640	\$14,303,681

CYGAM ENERGY INC.
Notes to the Consolidated Financial Statements
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8. SHARE CAPITAL (continued)

c) Warrants and Broker/Agent Options

The following table summarizes the warrants and broker/agent options outstanding as at December 31, 2006:

	Number	Exercise Price	Expiry Date
Series "A" warrants	11,955,554	\$ 0.60	October 11, 2007
Series "B" warrants	2,386,000	\$ 0.80	July 11, 2007
Broker/agent options	900,000	\$ 0.60	October 11, 2007
Total	15,241,554		

Each warrant entitles the warrant holder to acquire one Common Share of the Company at the exercise price. The 11,066,666 Series 'A' warrants which were issued in connection with the reverse takeover detailed in note 3 were accounted for at carrying value therefore, it is not appropriate to account for the fair value of these warrants. The carrying value of each entity has been wholly allocated to the common shares issued in this transaction.

d) Stock Options

The Company has a stock option plan (the "Plan") for directors, senior officers, employees and key consultants of the Company. Options granted pursuant to the Plan do not exceed a term of five years, and are granted at an option price and on other terms that the directors determine are necessary to achieve the goal of the Plan and in accordance with regulatory policies. Options vest one-half immediately and one-half one year later for directors and senior officers, and one-third immediately, one-third one year later, and one-third one year after that for consultants and employees. As at December 31, 2006, there were 5,025,000 stock options outstanding with a weighted average exercise price of \$0.65, of which 3,891,667 were exercisable at a weighted average exercise price of \$0.64. The following table summarizes the information regarding the Plan activity to December 31, 2006:

	Options Outstanding	Weighted Average Exercise Price
	(#)	(\$)
Granted on October 11, 2005	5,400,000	0.63
Balance, December 31, 2005	5,400,000	0.63
Granted, in February 2006	350,000	0.88
Cancelled in February 2006	(725,000)	0.60
Exercised	-	-
Balance, December 31, 2006	5,025,000	0.65

Exercise Price	Options Outstanding	Weighted Average Contractual Life (years)
\$0.60	4,425,000	3.78
\$0.83	100,000	4.09
\$0.90	250,000	4.09
\$1.31	250,000	3.90
	5,025,000	3.81

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8. SHARE CAPITAL (continued)

e) Stock-Based Compensation

The Company has calculated its stock-based compensation expense using the Black-Scholes option pricing model to estimate the fair value of stock options issued at the date of the grant. The weighted average fair market value per option granted in 2006 and the assumptions used in their determination are as follows:

	2006	2005
Weighted average fair value per option	\$ 0.27	\$ 0.22
Risk free interest rate (%)	4.5	4.5
Volatility (%)	40	30
Expected life (years)	5	5

f) Escrow Shares

57,710,056 common shares and 11,381,110 Series "A" warrants acquired by certain directors and related parties in connection with the reverse takeover and the non-brokered private placement completed on the October 11, 2005, are subject to two escrow agreements. Pursuant to the first agreement, 56,905,555 common shares and 11,381,110 Series "A" warrants are subject to the TSX Venture Exchange's Tier 2 Surplus Escrow, and under the second agreement 804,501 common shares are subject to the Exchange's Tier 2 Value Escrow.

The Surplus Escrow agreement provides for the release of these securities as to 5% on each of the 6, 12, 18, and 24 month anniversaries of the issuance of the Final Exchange Bulletin (October 21, 2005), and as to 10% on each of the 30, 36, 42, 48, 54, 60, 66 and 72 month anniversaries of the Final Exchange Bulletin. The Escrow agreement allows the shareholders to apply for accelerated release under certain circumstances.

The Value Escrow agreement provides for the release of these securities as to 25% on the issuance of the Final Exchange Bulletin ("Initial Release") and 25% on each of the 6, 12, and 18 month anniversaries of the Initial Release.

9. CONTRIBUTED SURPLUS

The following table sets out the changes in Contributed Surplus related to the stock based compensation expense, warrants and broker/agent options:

	2006	2005
Balance, beginning of year	\$ 977,829	\$ -
Stock based compensation	459,932	553,809
Series "A" warrants	-	110,578
Series "B" warrants	(1,175)	201,474
Broker/agent options	-	111,968
Balance, end of year	\$ 1,436,586	\$ 977,829

CYGAM ENERGY INC.
Notes to the Consolidated Financial Statements
Years ended December 31, 2006 and 2005

10. PER SHARE AMOUNTS

Basic earnings per share is calculated using the weighted average number of shares outstanding during the year. Diluted earnings per share is calculated to reflect the dilutive effect of stock options and warrants outstanding.

Earnings per share is calculated as follows:

	2006		
	Net loss	Shares	Loss per share
Basic	\$ (2,389,009)	72,343,925	\$ (0.033)
Effect of assumed exercise of options and Warrants		4,245,612	
Diluted	\$ (2,389,009)	76,589,537	\$ (0.033)

	2005		
	Net earnings	Shares	Earnings per share
Basic	\$ 3,494,828	48,556,683	\$ 0.072
Effect of assumed exercise of options and warrants		5,272,330	
	\$ 3,494,828	53,829,013	\$ 0.065

CYGAM ENERGY INC.
Notes to the Consolidated Financial Statements
Years ended December 31, 2006 and 2005

11. INCOME TAXES

a) Future income tax recovery

The provision for income taxes differs from the result that would be obtained by applying the combined Canadian federal and provincial statutory tax rates to income before taxes. The difference results from the following:

	2006	2005
Earnings before tax	\$ (2,440,480)	\$ 3,483,850
Income tax rate	32.5%	37.62%
Computed income taxes at the Canadian income tax rate	(793,156)	1,310,624
Increase (decrease) in taxes resulting from:		
Non-deductible crown payments, net of		
ARTC and resource allowance	14,380	6,210
Stock-based compensation	149,478	208,342
Statutory rate differences, effect of rate changes and other	535,500	(1,576,308)
Recovery of prior year taxes paid	(60,354)	-
Change in valuation allowance	102,681	40,154
Recovery of income taxes	\$ (51,471)	\$ (10,978)

b) The components of the net future income tax liability are as follows:

	2006	2005
Future Income Tax Assets:		
Non-capital losses	\$ -	\$ (21,042)
Asset retirement obligation	(29,543)	(27,075)
Share issue costs	(102,829)	(148,888)
Subsidiary non-capital losses	(142,835)	(40,154)
Valuation allowance	142,835	40,154
	(132,372)	(197,005)
Future Income Tax Liabilities:		
Property, plant and equipment	306,205	361,955
Net Future Tax Liability	\$ 173,833	\$ 164,950

CYGAM ENERGY INC.
Notes to the Consolidated Financial Statements
Years ended December 31, 2006 and 2005

12. SEGMENT INFORMATION

The Company operates in the oil and gas industry. Its reportable segments are identified on a geographic basis.

Geographic Segments:

December 31, 2006	Canada	Italy	Tunisia	Total
Gross Revenue	1,079,924	96,487	0	1,176,411
Loss before taxes	1,939,675	373,100	127,705	2,440,480
Total assets (net of				
Inter-company balances)	11,815,792	1,110,571	4,995,969	17,922,332
Property and equipment	1,997,268	866,669	5,816,333	8,680,270
Capital Expenditures	563,515	819,182	1,260,349	2,643,046
December 31, 2005	Canada	Italy	Tunisia	Total
Gross Revenue	337,936	389	104,200	442,525
Loss (income) before taxes	1,563,728	119,434	(5,167,012)	(3,483,850)
Total assets (net of				
Inter-company balances)	15,296,914	240,641	4,463,309	20,000,864
Property and equipment	1,639,782	36,134	4,336,559	6,012,475
Capital Expenditures	113,021	-	1,450,575	1,563,596

13. FINANCIAL INSTRUMENTS

The Company's financial instruments recognized in the balance sheet consist of marketable securities, accounts receivable, accounts payable, accrued liabilities and bank loan. The carrying value of these balance sheet items approximate their fair market value.

In management's opinion, the Company is not exposed to significant currency, credit or interest rate risk in relation to these financial instruments.

CYGAM ENERGY INC.
Notes to the Consolidated Financial Statements
Years ended December 31, 2006 and 2005

14. COMMITMENTS

(a) Rigo Oil Company Tunisia Ltd. (“ROCT”), is a partner in the Jorf exploration permit, and the operator of the Sud Tozeur prospecting licence. Under the terms of the exploration permit, the operator and its partners are obligated to drill one well to the depth of 2,500 meters within the term of the permit which expires on August 6, 2007. The permit is currently in good standing.

Under the terms of the Sud Tozeur prospecting licence which expires on February 27, 2007, ROCT is obligated to re-interpret existing seismic data and acquire 50 kilometres of new seismic lines and has an option to convert the licence to a four year exploration permit. An additional 61 kilometres of new seismic was completed in January 2007 and the Tunisian authorities approved the conversion of the prospecting licence to an exploration permit on March 14, 2007.

(b) The Company rents premises in Rome, Italy, under operating leases that require payments of \$88,000 in each of 2007 and 2008, and the lease is subsequently renewable for a further four years. The Company rents premises in Tunis, Tunisia, under operating leases that require payment of \$55,000 in 2007, and the lease is renewable annually.

(c) In the ordinary course of business, the Company and its subsidiaries may enter into contracts which contain indemnification provisions, such as service agreements, leasing agreements, asset purchase and sale agreements, joint venture agreements, operating agreements, land use agreements, etc. In such contracts, the Company may indemnify counterparties to the contracts if certain events occur. These indemnification provisions vary on an agreement-by-agreement basis. In some cases, there are no pre-determined amounts or limits included in the indemnification provisions and the occurrence of contingent events that will trigger payment under them is difficult to predict. Therefore, the maximum potential future amount that the Company could be required to pay cannot be estimated.

15. RELATED PARTY TRANSACTIONS

(a) Included in the general and administrative expenses are consulting fees of \$284,064 (2005 -\$39,312) and contract termination payments of \$nil (2005 - \$238,000) paid to officers of Cygam or companies whose shareholders are directors and officers of Cygam or were directors and officers of Sheer Energy Inc. The Company also capitalized \$59,976 (2005 -\$nil) paid during the year to a director and officer of the Company.

(b) During the period ended December 31, 2006, \$21,671 (2005 - \$42,976) in legal fees was incurred, of which \$5,013 are owed at year end to a legal firm in which a director of the Company is a partner.

CYGAM ENERGY INC.

Notes to the Consolidated Financial Statements

Years ended December 31, 2006 and 2005

15. RELATED PARTY TRANSACTIONS (continued)

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- (c) Effective May 31, 2006, Cygam acquired free carried interests in three exploration permits in Italy from Vittorito Petroleum S.r.L., a private corporation whose 50% owner subsequently became a director of the Company. The total purchase price of \$615,000 comprised \$300,000 in cash which was paid prior to the year end and 484,614 common shares and 200,000 Series "C" Warrants of the Company issued after December 31, 2006. The purchase agreement further provides for the issuance of up to a maximum of 1,000,000 common shares in the event of a discovery and establishment of proven and producing reserves of a minimum of 10 million barrels of oil equivalent.

All the transactions above are in the normal course of operations, and have been measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties and which are similar to those negotiated with third parties.

16. SUBSEQUENT EVENTS

- (a) On January 4, 2007, the Company's wholly owned subsidiary, Vega Oil S.p.A., received confirmation of the final ministerial approval for the Aretusa (C.R148.VG) exploration permit.
- (b) On January 8, 2007, the Company issued 484,614 common shares and 200,000 Series "C" Warrants pursuant to the purchase of free carried interests in three exploration permits in Italy from Vittorito Petroleum S.r.L. Each Series "C" Warrant is exercisable into one common share at an exercise price of \$1.50 per share for a period of two years.
- (c) On March 19, 2007, the Company entered into an agreement to farm-out a 20% working interest in the Jorf exploration permit in Tunisia. The interest may be earned by farm-out partner by paying 30% of the seismic program and subsequent drilling and completion costs in the first identified drillable structure on the permit. The farm-out partner paid 30% of the costs of the seismic program upon entering into the agreement.
- (d) On March 29, 2007, the Company announced a brokered private placement to raise gross proceeds of up to \$10 million.

CYGAM ENERGY INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS YEAR ENDED DECEMBER 31, 2006

This Management's Discussion and Analysis (MD&A) is a review of operations, current financial position and outlook for Cygam Energy Inc. (Cygam or the Company) and should be read in conjunction with the audited annual consolidated financial statements for the year ended December 31, 2006. This MD&A is dated as of April 25, 2007.

The audited consolidated financial statements have been prepared by management and approved by Cygam's Audit Committee on behalf of the Board of Directors. These statements are based on certain estimates and assumptions and involve risks and uncertainties. Actual results may differ materially. Refer to the Business Risks section of this MD&A for additional information related to identified risks, estimates and uncertainties.

All financial information is reported in Canadian dollars and is in accordance with Canadian generally accepted accounting principles (GAAP) unless otherwise noted. Natural gas has been converted into barrels of oil equivalent (boe) at 6:1. The abbreviation boe, boe per day and mboe disclosed in this MD&A may be misleading, particularly if used in isolation. A boe conversion ratio of 6 mcf: 1 boe is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

Cautionary Statement regarding Forward-Looking Information

Certain statements contained in this MD&A including statements which contain words such as "anticipate", "could", "should", "expect", "seek", "may", "intend", "likely", "will", "believe" and similar expressions, statements relating to matters that are not historical facts, and statements of our beliefs, intentions and expectations about development, results and events which will or may occur in the future, constitute "forward-looking information" within the meaning of applicable Canadian securities legislation and are based on certain assumptions and analysis made by us derived from our experience and perceptions. Forward-looking information in this MD&A includes, but is not limited to: statements relating to "reserves" and "resources" as they involve the implied assessment, based on certain estimates and assumptions that the resources and reserves described can be profitably produced in the future; expected cash provided by continuing operations; future capital expenditures, including the amount and nature thereof; oil and natural gas prices and demand; expansion and other development trends of the oil and natural gas industry; business strategy and outlook; expansion and growth of our business and operations; the maintenance of existing government, supplier and partner relationships; supply channels; accounting policies; balance sheet financial instruments; credit risks; and other such matters.

All such forward-looking information is based on certain assumptions and analyses made by us in light of our experience and perception of historical trends, current conditions and expected future developments, as well as other factors we believe are appropriate in the circumstances. The risks, uncertainties, and assumptions are difficult to predict and may affect operations, including, without limitation: the risks associated with foreign operations; foreign exchange fluctuations; commodity prices; equipment and labour shortages and inflationary costs; general economic conditions; industry conditions; changes in applicable environmental, taxation and other laws and regulations as well as how such laws and regulations are interpreted and enforced; the ability of oil and natural gas companies to raise capital; the effect of weather conditions on operations and facilities; the existence of operating risks; volatility of oil and natural gas prices; oil and natural gas product supply and demand; risks inherent in the ability to generate sufficient cash flow from operations to meet current and future obligations; increased competition; stock market volatility; opportunities available to or

pursued by us and other factors, many of which are beyond our control. The foregoing factors are not exhaustive and are further discussed herein under the heading "Business Risks and Uncertainties".

Actual results, performance or achievements could differ materially from those expressed in, or implied by, this forward-looking information and, accordingly, no assurance can be given that any of the events anticipated by the forward-looking information will transpire or occur, or if any of them do so, what benefits will be derived therefrom. Except as required by law, Cygam Energy Inc. disclaims any intention or obligation to update or revise any forward-looking information, whether as a result of new information, future events or otherwise.

The forward-looking information contained herein is expressly qualified by this cautionary statement.

REVERSE TAKE-OVER

Effective October 11, 2005, Cygam (formerly Sheer Energy Inc.) completed a reverse take-over (the "RTO Transaction") involving the acquisition of all the issued and outstanding shares of Rigo Oil Company Limited ("ROCL"), Vega Oil S.p.A. ("Vega"), whereby the shareholders of ROCL acquired control of Cygam. The RTO Transaction resulted in change of control of Cygam, including the resignation and subsequent appointment of certain new directors and officers.

In accordance with accounting for reverse take-over, the consolidated financial statements of the Company treat ROCL as the acquiring company and therefore all results prior to the acquisition date of October 11, 2005 reflect the operations of ROCL only.

EXPLORATION ACTIVITIES

The Company conducted exploration activities during the year ended December 31, 2006 in Canada, Italy and Tunisia as described in the "International Operations Review"

FINANCIAL PERFORMANCE Selected Financial Information

Twelve months ended December 31

	2006	2005
	\$	\$
Oil and gas revenue	596,312	286,300
Royalties, net of ARTC	(118,032)	(76,275)
Other revenue	698,131	232,500
Total net revenue	1,176,411	442,525
Operating costs	218,342	52,942
Depletion, amortization and accretion	216,168	42,178
General & administration	1,178,726	527,815
Interest	4,922	2,541
Stock-based compensation expense	459,932	553,809
Loss (gain) on foreign exchange	3,923	(325,363)
	2,082,013	853,922
	(905,602)	(411,397)
Gain on sale of marketable securities	-	4,827,555
Unrealized loss on marketable securities	(1,534,878)	(932,308)
Net earnings (loss)	(2,440,480)	3,483,850
Current and future income tax recovery	51,471	10,978
Net earnings (loss) after tax	(2,389,009)	3,494,828

In accordance with the accounting for reverse takeovers, the results for the year ended December 31, 2005 are for ROCL only for the period from January 1, 2005 to October 11, 2005 and include the Canadian operations, ROCL and Vega for the period from the date of the reverse takeover to December 31, 2005.

Oil and Gas Revenue

Oil and gas revenues (net of royalties) for the year ended December 31, 2006 of \$ 596,312 represents revenue from the Canadian operations. The oil and gas revenue of \$286,300 for 2005 represents revenue in the fourth quarter of the year after the reverse takeover, and comparative amounts on barrels of oil equivalent per day (boe/d) basis are for that fourth quarter period. Production for the year was 36.35 (2005 – 38.04) boe/d, comprising approximately 70% natural gas and 30% oil and NGLs, at an average price of \$44.94 per boe (2005 - \$81.80). The decrease in revenue per boe was largely due to a decrease in the average price of natural gas received by the Company from \$11.52 per mcf in the fourth quarter of 2005 to \$6.71 per mcf in 2006.

Crown and production royalties (net of ARTC) was \$118,032 or \$8.89 per boe, whilst operating expenses were \$218,342 or \$16.46 (2005 – 15.13) per boe.

Other Revenue

Other revenue for the year ended December 31, 2006 includes distributions of \$331,426 (2005 - \$176,155) received from investments in marketable securities, and interest income of \$270,216 (2005 - \$56,345) on cash balances invested in short-term fixed income securities.

Gain on Sale of Marketable Securities

Prior to the reverse takeover on October 11, 2005, ROCL disposed of its portfolio of marketable securities for a net gain of \$4,827,555 in 2005.

Unrealized Loss on Marketable Securities

As noted earlier, Cygam's reverse takeover included the acquisition of units of a public entity. At the time of the acquisition, management had designated these units as held for trading with the intent to dispose of these units when funds were required for exploration activities. At December 31, 2006 the units are stated in the financial statements at fair value of \$3,532,814 (2005 - \$5,067,692) resulting in an unrealized loss of \$1,534,878 during the year.

Net Income

The net loss before tax for the period was \$2,440,480 (2005 – net earnings \$3,483,850). After adjusting for non-cash items, including depletion, amortization and accretion, stock based compensation expense and the unrealized loss on marketable securities, the Company had a net loss after tax of \$230,092.

General and Administrative Expenses

During the year, the Company generated sufficient revenue from the Canadian oil and gas assets, from the investment in marketable securities and from short term fixed income securities to pay for most the Company's general and administration expenses of \$1,178,726 (2005- \$527,815). The increase in G&A expenses resulted from an increase in staff in the Rome office and the opening of our Tunis office and the hiring of a permanent Resident Manager in July 2006 in the Tunis office.

G&A includes \$284,064 in consulting fees paid to directors and officers of Cygam, or to companies whose shareholders are directors and officers of Cygam, \$21,671 in legal fees paid to a legal firm in which a director of the Company is a partner, \$180,288 paid in connection with the services of the new Resident Manager in Tunisia, and \$77,567 was incurred during the year on travel and accommodation expense in connection with travel to Tunisia and Rome for meetings with the

authorities and potential joint venture partners and travel to London (UK) for meetings with potential investors.

For the year ended December 31, 2006, the Company capitalized \$207,382 (2005 - \$ 98,935) of general and administrative expenses that were directly related to the acquisition and exploration of oil & gas properties in Tunisia and Italy.

Stock-based Compensation

Stock-based compensation represents a non-cash charge resulting from applying fair value method on stock options issued by the Company during the period. Under this method, compensation expense related to this program is recorded in the statement of operations over their respective vesting periods. The amount of compensation cost recognized in the period is based on the fair value the stock options vesting in 2006.

Stock-based compensation for the year was \$459,932 (2005 - \$553,809). In February 2006, the Board of Directors granted 250,000 stock options to a new director and 100,000 stock options to a consultant. In February 2006, 725,000 unvested options previously issued to a director who passed away were cancelled in accordance with the Company's stock option plan.

Depletion, Amortization and Accretion

Depletion, Amortization and Accretion ("DA&A") amounted to \$216,168 including depletion and accretion amount of \$191,536 (\$14.43 /boe) for the period related to oil and gas production from Canadian properties. The cost of unproved properties of \$6,598,564 (2005 - \$4,352,789) is excluded from the DA&A calculation and is assessed periodically to ascertain whether impairment has occurred.

SUMMARY OF QUARTERLY INFORMATION

The following is a summary of selected financial information for the Company for the past eight quarters.

	2006			
	Q4	Q3	Q2	Q1
P&G sales (net of royalties)	\$ 126,633	122,459	93,664	135,524
Other revenue	240,789	153,872	158,887	144,583
	<hr/>	<hr/>	<hr/>	<hr/>
Expenses	367,422	276,331	252,551	280,107
	728,105	445,017	483,688	421,280
	<hr/>	<hr/>	<hr/>	<hr/>
Earnings (loss) before items below	(360,683)	(168,686)	(231,137)	(141,173)
Gain on sale of marketable securities	-	-	-	-
Unrealized gain (loss) on				
marketable securities	(445,095)	(748,478)	(496,988)	155,683
Foreign exchange gain (loss)	2,045	(3,484)	(2,484)	-
	<hr/>	<hr/>	<hr/>	<hr/>
Net earnings (loss) before income taxes	(803,733)	(920,648)	(730,609)	\$ 14,510
Current and future income tax recovery	62,461	(15,990)	5,000	-
	<hr/>	<hr/>	<hr/>	<hr/>
Net earnings after tax	(741,272)	(936,638)	(725,609)	\$ 14,510
	<hr/>	<hr/>	<hr/>	<hr/>
Net income (loss) per share	(0.01)	(0.01)	(0.01)	0.00
	<hr/>	<hr/>	<hr/>	<hr/>
Production (boe/d)	37.64	38.28	32.32	37.12

				2005
	Q4	Q3	Q2	Q1
P&G sales (net of royalties)	\$ 205,025	-	-	-
Other revenue	128,299	-	53,920	50,281
	<u>333,324</u>	<u>-</u>	<u>53,920</u>	<u>50,281</u>
Expenses	1,179,285	-	-	-
Earnings (loss) before items below	(840,961)	-	53,920	50,281
Gain on sale of marketable securities	-	-	4,827,555	-
Unrealized gain (loss) on marketable securities	(932,308)	-	-	-
Foreign exchange gain (loss)	(58,486)	-	376,860	6,989
	<u>(1,831,755)</u>	<u>376,860</u>	<u>4,888,464</u>	<u>50,281</u>
Current and future income tax recovery	10,978	-	-	-
	<u>(1,820,777)</u>	<u>376,860</u>	<u>4,888,464</u>	<u>50,281</u>
Net earnings after tax	(0.037)	0.009	0.117	0.001
Net income (loss) per share	38.04	n/a	n/a	n/a
Production	38.04	n/a	n/a	n/a

Revenue from oil and gas sales (net of royalties) fluctuates from quarter to quarter largely due to fluctuations in the price of oil and natural gas received by the Company (see earlier comments on Revenue). The production each quarter has not changed by a significant amount except in the third quarter of 2006 when some facilities were shut-in for maintenance.

As noted earlier, the Company's expenses have increased each quarter as the Company has grown the number of employees and related office expenses in the Rome and Tunis offices to conduct the increased amount of seismic acquisition, processing and interpretation activity, and prepare plans to drill on a number of permits in Italy and Tunisia in 2007. Expenses in the fourth quarter of 2005 include significant costs relating to the reverse take-over transaction.

LIQUIDITY AND CAPITAL RESOURCES

The Company had a net working capital balance of \$8,479,705, including a cash balance of \$5,321,555 as at December 31, 2006. Cash balances in excess of planned requirements were invested in short-term fixed income securities generating \$270,216 in interest income for the year, and the Company continues to receive a monthly distribution of \$27,943 from its investment in marketable securities. On March 29, 2007, the Company announced a brokered private placement to raise up to \$10 million at a price per common share to be determined in the context of the market.

The Company's cash balance and additional funds from the liquidation of the marketable securities are expected to be sufficient to fund the planned first phase of the exploration program over the next year assuming the Company is able to negotiate and fund a portion of the exploration plan through joint ventures. The Company, through its subsidiaries in Italy and Tunisia, has either entered into agreements or has received expressions of interest from third parties to participate in the exploration program on several of the permits on the basis of "pay 60% to earn 40% interest". The Company will examine each interest on a permit by permit basis to determine the level and amount of participation offered to third parties. The planned capital expenditures program for the next twelve months, net to Cygam, of approximately \$10,125,000 will be primarily funded from the Company's cash, working capital and proceeds from equity financings and the exercise of outstanding warrants and agent's options.

SHARE CAPITAL

The Company is authorized to issue an unlimited number of common shares as well as first preferred non-voting shares. To date, no preferred shares have been issued. The Company's share capital as at December 31, 2006 is outlined below:

	Shares	Amount (\$)
Outstanding shares at December 31, 2005	72,335,640	\$ 14,291,305
Issued upon exercise of Series "B" warrants	14,000	12,386
Outstanding shares at December 31, 2006	72,349,640	\$14,303,681
Issued on purchase of Vittorito interest	484,614	294,498
Issued upon exercise of Series "B" warrants	15,000	13,259
Issued upon exercise of Agent's option	80,000	57,953
Outstanding shares at April 25, 2007	<u>72,929,254</u>	<u>\$14,669,391</u>

As noted earlier 350,000 stock options were granted and 725,000 stock options were cancelled during the year. No shares were issued and no stock options were granted or exercised during the quarter ended December 31, 2006. The total number of stock options granted as at December 31, 2006 was 5,025,000 and as at the date of this MD&A was 4,300,000 following the expiry of 725,000 stock options in February 2007, and the total number of warrants and agent options issued was 15,241,554.

BUSINESS RISKS AND UNCERTAINTIES

Cygam is in the business of exploring for, developing and producing oil and natural gas. The Company has production operations in Canada, and exploration activities in Italy and Tunisia. Along with the competitive nature of the oil and gas industry, risk exposures, some of which are beyond the control of the Company, can be categorized as operational, political, regulatory, environmental and financial. The long-term commercial success of Cygam depends on its ability to find, acquire, develop and commercially produce oil and natural gas reserves. Oil and natural gas exploration involves a high degree of risk and there is no assurance that expenditures made on future exploration by the Company will result in new discoveries of oil or natural gas in commercial quantities. It is difficult to project the costs of implementing an exploratory drilling program due to the inherent uncertainties of drilling in unknown formations, the costs associated with encountering various drilling conditions and changes in drilling plans and locations as a result of prior exploratory wells or additional seismic data and interpretations thereof.

The process of evaluating prospects and estimating oil and natural gas reserves is complex and subject to uncertainty. Actual operating results, including production performance, may vary from those estimated, possibly materially. Cygam manages these risks by having operational control, where possible, and working interests commensurate with the assessed risk in each project and by hiring qualified professionals, including independent reserves engineers, with appropriate industry experience.

The Company focuses the majority of its activities on exploration in Tunisia and Italy. Some of the Company's operations and related assets are located in countries which carry a higher degree of political and economic risk. Cygam's management has considerable expertise operating internationally and has developed solid, long-term relationships within each of the jurisdictions in which it operates. The Company adheres to all governmental and environmental regulations as they apply in each operating jurisdiction. Regulation changes could increase costs of the Company's operations.

Cygam's current production base in Canada is heavily weighted to natural gas which is subject to price fluctuations based on North American natural gas supply and demand conditions. Oil and natural gas are commodities whose prices have fluctuated widely in recent years and are determined based on world demand, supply and other factors, all of which are beyond the control of the Company.

Cygam maintains an insurance program which is consistent with industry practice to provide adequate coverage of drilling, operations, safety and the environment.

RELATED PARTY TRANSACTIONS

Transactions between the Company and related parties occurred during the year, as disclosed in the notes to the consolidated financial statements. During the year, the Company paid \$284,064 as consulting fees to related parties, which is included in the G&A expenses and a further \$59,976 was capitalized by Vega S.p.A. The Company also paid \$21,671 in legal fees to a legal firm in which a director of the Company is a partner.

Effective May 31, 2006, Cygam acquired free carried interests in three exploration permits in Italy from Vittorito Petroleum S.r.L., a private corporation whose 50% owner subsequently became a director of the Company. The total purchase price of \$615,000 comprised \$300,000 in cash which was paid prior to the year end and 484,614 common shares and 200,000 Series "C" Warrants of the Company issued after December 31, 2006. The purchase agreement further provides for the issuance of up to a maximum of 1,000,000 common shares in the event of a discovery and establishment of proven and producing reserves of a minimum of 10 million barrels of oil equivalent.

All such transactions were in respect of technical and specialized services rendered in the normal course of business operations and represent consideration established and agreed to by the related parties which is similar to those negotiated with third parties.

CONTRACTUAL OBLIGATIONS AND COMMITMENTS

In the ordinary course of business, the Company and its subsidiaries may enter into contracts which contain indemnification provisions, such as service agreements, leasing agreements, asset purchase and sale agreements, joint venture agreements, operating agreements, land use agreements, etc. In such contracts, the Company may indemnify counterparties to the contracts if certain events occur. These indemnification provisions vary on an agreement by agreement basis. In some cases, there are no pre-determined amounts or limits included in the indemnification provisions and the occurrence of contingent events that will trigger payment under them is difficult to predict. Therefore, the maximum potential future amount that the Company could be required to pay cannot be estimated.

Rigo Oil Company Tunisia Ltd. (ROCT) is the operator of the Jorf exploration permit, and the operator of the Sud Tozeur prospecting licence. Under the terms of the exploration permit, the operator and its partners are obligated to drill one well to the depth of 2,500 meters within the term of the permit which has now been extended to August 6, 2007. The Company plans to drill a well on this permit in July 2007. Under the terms of the Sud Tozeur prospecting licence, which expires on February 24, 2007, ROCT is obligated to re-interpret existing seismic data and acquire 50 kilometers of new seismic lines and has an option to convert the licence to a four year exploration permit. In January 2007, the Company completed an additional 60 kilometers of seismic, and made an application to convert the prospecting license to an exploration permit.

The Company rents premises in Rome, Italy, and in Tunis, Tunisia, under operating leases that require payments of \$88,000 per annum in each of 2006 and 2007 in Rome and \$55,000 per annum in Tunis.

CRITICAL ACCOUNTING ESTIMATES

Cygam's significant accounting policies are disclosed in Note 2 to the audited consolidated financial statements for the year ended December 31, 2006. Certain accounting policies require that management make appropriate decisions with respect to the formulation of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. The following discusses such accounting policies and is included in the MD&A to assist the reader in assessing our critical accounting policies and practices and the likelihood of materially different results being reported. As management, we review estimates regularly.

The emergence of new information and changed circumstances, including accounting standards, may result in actual results or changes to estimated amounts that differ materially from current estimates.

Reserves Determination

The petroleum and natural gas reserves used in determining our depletion rates and the ceiling test are based upon management's best estimates, and are subject to uncertainty. Through the use of geological, geophysical and engineering data, the reservoirs and deposits of petroleum and natural gas are examined to determine quantities available for future production, given existing operating and economic conditions and technology. The evaluation of recoverable reserves is an ongoing process impacted by current production, continuing development activities and changing economic conditions as reflected in crude oil and natural gas prices and costs. Consequently, the reserves are estimates which are subject to variability. We employ the services of independent oil and gas reservoir engineers (Fekete Associates Inc. and Matsalla Consulting (1981) Ltd.) to assist with the reserve evaluation process for the Canadian properties.

Full Cost Accounting for Oil and Gas Activities

Cygam uses the full cost method of accounting for exploration and development activities. In accordance with this method of accounting, all costs associated with exploration and development, are capitalized whether successful or not. The aggregate of net capitalized costs and estimated future development costs is amortized using the unit-of-production method based on estimated proved oil and gas reserves before royalties, as determined by qualified independent petroleum evaluation engineers. Accordingly, changes in estimated proved oil and gas reserves and estimated future development costs would result in changes to the depletion rate. Certain costs related to unproved properties and major development projects may be excluded from costs subject to depletion until proved reserves have been determined or their value is impaired. These properties are assessed periodically and any impairment is transferred to the costs subject to depletion.

Asset Impairments

Under full cost accounting, a ceiling test is performed to ensure that unamortized capitalized costs in each cost centre (country) do not exceed their fair value. Impairment is recognized when the carrying value is greater than the undiscounted future cash flows. In the event of impairment, the amount by which the carrying value exceeds the estimated fair value of the long-lived asset is charged to earnings. Fair value is determined using expected future product prices and costs, and amounts are discounted using a risk-free interest rate.

Asset Retirement Obligations

The fair value of the future retirement obligation is discounted to present value and is recorded as an increase to the related property and equipment with the corresponding balance recorded as a future asset retirement obligation. The increased asset value is amortized according to our policies for property and equipment and the future liability is accreted to expense until the future retirement obligation is expected to be settled.

Stock-Based Compensation

The Company uses the fair value method for valuing stock option grants. Under this method, compensation cost attributable to all stock options granted is measured at fair value at the grant date, using the Black-Scholes valuation model, and expensed over the vesting period with a corresponding increase to contributed surplus. Upon exercise of options, consideration received together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

Accounting for Derivative Instruments and Hedging Activities

Cygam has not entered into any hedging arrangements.

Income Tax Accounting

The determination of the Company's income and other tax liabilities requires interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded by management.

Legal, Environmental Remediation and Other Contingent Matters

Cygam is required to both determine whether a loss is probable, based on judgment and interpretation of laws and regulations, and determine that the loss reasonably be estimated and included in the Company's financial statements. Management continually monitors known and potential contingent matters and makes appropriate provisions by charges to earnings when warranted by circumstances.

Disclosure Controls and Procedures

Internal controls over financial reporting and disclosure controls and procedures have been designed to ensure that information required to be disclosed by the Company is accumulated and communicated to the Company's management as appropriate to allow timely decisions regarding required disclosures. It should be noted that while the Company's management believe that the Company's disclosure controls and procedures provide a reasonable level of assurance that they are effective, they do not expect that the disclosure controls and procedures or internal control over financial reporting will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

NEW ACCOUNTING STANDARDS

In 2005 the Canadian Institute of Chartered Accountants issued the following new Handbook Sections: Section 1530, Comprehensive Income; Section 3251, Equity; Section 3855, Financial Instruments – Recognition and Measurement; and Section 3865, Hedges. The effective date for adoption for all four sections for Cygam is January 1, 2007. These new accounting standards for Canadian GAAP emphasize the use of fair value rather than historical cost as the basis for accounting for financial instruments. The Company has not chosen early adoption of these new accounting standards and is in the process of assessing the future impact these sections will have on the financial statements.

The Accounting Standards Board (AcSB) has proposed that Canadian GAAP for publicly accountable enterprises will migrate to International Financial Reporting Standards (IFRS) over a transition period in the next five years. The Company will assess the impact this proposal will have on the financial statements.

OUTLOOK

The outlook for the next year is described in the "International Operations Review".

